



Republican Policy Committee

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A Startling Glimpse at Punitive Damages

Do we want our civil justice system to drive worthy products and services from the market? The case study below from Alabama describes a real-life scenario involving insurance and punitive damages that exemplifies why —without legal reform— a needed service, such as low-cost life insurance, may become an unobtainable commodity.

The Gorton substitute to H.R. 956 (S. 565) creates a consistent standard for the award of punitive damages and limits punitive damages in proportion to the harm caused in product liability cases. The Dole/Hatch amendment being offered today would extend these punitive damages in the Gorton substitute to all civil actions involving interstate commerce. [Note, however, that the amendment does not alter federal law, so such areas as civil rights and environmental laws are unaffected.]

The Administration yesterday released its official position on the Gorton substitute, opposing it in part because it finds the "artificial ceiling" for punitive damages "objectionable." According to the statement issued by OMB, "the Administration believes statutory caps are improper because they ignore the fundamental purpose of punitive awards: to punish and deter." On reading the following, one might ask the question, whom does current law punish and whom does it deter?

The Alabama Case: *Gallant v. Prudential Insurance Company*

An Alabama couple purchased a life insurance/annuity policy from Prudential Life Insurance Company. The policy had a face value of \$25,000, and a monthly premium of about \$39. This was the least expensive policy of its type available on the market; it was designed for persons of modest means.

At the time of the sale, the Prudential agent told the couple that the value of their annuity was about twice what it actually was. Using a brochure that described the policy, the agent had added together the table showing "projected return" and another showing "guaranteed return." A jury in 1994 found this action fraudulent, and it held Prudential liable for failing to supervise the agent properly.

The agent's misrepresentation was discovered before either policyholder had died and before either had retired. At the time of trial, therefore, there had been no true economic loss beyond the failed expectation of a larger return. During trial, the couple testified that between the

time they discovered the problem, and the time Prudential telephoned them to offer to return their premiums or to adjust the policy, they had suffered about two weeks of sleepless nights and substantial anger at having been misled. That was the extent of their mental anguish.

The trial lasted a day and a half. An Alabama jury awarded the couple \$30,000 for economic loss, \$400,000 for mental anguish, and \$25,000,000 (twenty-five million dollars) in punitive damages. (Because Prudential is a mutual insurance company, this verdict will reduce dividends to every Alabama policyholder by about \$323.) The judge affirmed the award, but directed that part of the punitive damages be paid to the state.

Verdicts such as this one help explain why some states are major growth centers for lawsuits. The Alabama Business Council says that juries in Alabama awarded over \$200,000,000 in punitive damages in less than 12 months in 1994 alone. Meanwhile, in the case described above, an expert witness testified at trial that, over the term of the policy, the insurance company would have made a profit of \$46 (forty-six dollars) on the policy.

Now, how will an insurer respond to such numbers? The rational response is to quit selling low-priced policies. It makes very little sense to expose the company to multimillion dollar verdicts for the prospect of a \$46 profit. Indeed, following the verdict in this case (and others with large punitive damages awards), several insurers have quit offering coverage of any kind in Alabama.

Is low-cost insurance the kind of service that our civil justice system should be driving from the market? Of course not, but if it does, low-income families will be the first to be hurt because they have fewer alternatives than higher-income families to provide for their financial security.

[Note: With the one exception, information (and sometimes the verbiage) in this paper was taken from written testimony for the Senate Judiciary Committee, April 4, 1995, by Professor George L. Priest, Yale Law School.]

**Punitive Damages Awards Affirmed by the
Alabama Supreme Court**
in millions of current dollars

1974-1978	4
1979-1983	4.2
1984-1988	33.2
1989-1993	89.6

(Note: These are only the awards that were reviewed by the state's highest court, not all of the awards granted by all of the courts throughout the state.
Source: Theodore Olson, testimony, Senate Judiciary Committee, 4/4/95)

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